84-1601

No. ——

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

AETNA LIFE INSURANCE CO.,

Appellant,

v.

MARGARET W. LAVOIE AND ROGER J. LAVOIE, SR.,

Appellees.

On Appeal From the Supreme Court of Alabama

JURISDICTIONAL STATEMENT

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QUESTIONS PRESENTED

1. Whether § 12-22-72, *Code of Alabama* (1975), under which a mandatory penalty of ten percent of any money judgment is automatically imposed on an unsuccessful defendant-appellant, but which imposes no corresponding burden on an unsuccessful plaintiff-appellant, is unconstitutional under the Equal Protection Clause of the Fourteenth Amendment of the Constitution of the United States.

2. Whether appellant's right to a fair, unbiased hearing of its appeal below, guaranteed by the Due Process Clause of the Fourteenth Amendment of the Constitution of the United States, was denied because of the participation in the consideration and decision of this case, an action for bad faith failure to pay an insurance claim, by a Justice of the Supreme Court of Alabama who, while this case was *sub judice* in the Supreme Court of Alabama and without any notice to the parties to this case, filed and continued to prosecute a civil class action seeking punitive damages against an insurer based on alleged bad faith failure to pay insurance claims, and who also filed a similar action while this case was *sub judice* in the Supreme Court of Alabama against another insurer, where several issues raised in and central to the litigation filed by that Justice are, or predictably will be, directly controlled by rulings of law rendered by the Supreme Court of Alabama in its judgment and opinion issued in this case.

3. Whether the subjection of appellant to punitive damages for conduct occurring in 1977 and 1978 in connection with the performance of appellant's contractual obligations violates the Contract Clause, Art I, § 10, cl. 1 of the Constitution of the United States, because it retroactively imposes a new, unanticipated and severe obligation on the contract between appellant and appellees, an obligation in the form of a cause of action which was not recognized by Alabama until 1981 and which has itself undergone substantial modification to appellant's detriment since 1981, particularly by the judgment and opinion in this case.

4. Whether the award of $3,500,000 in punitive damages against appellant is violative of the Excessive Fine Clause of the Eighth Amendment of the Constitution of the United

States as made applicable to the States through the Due Process Clause of the Fourteenth Amendment of the Constitution, and is otherwise invalid under the Due Process Clause of the Fourteenth Amendment because it is vastly out of proportion to actual damages, equally out of scale with any penalties for illicit business conduct prescribed by the Alabama legislature, and constitutes an arbitrary and capricious taking of appellant's property unjustified by any rational state purpose.*

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* All parties to this case are named in the caption. Appellant Aetna Life Insurance Company is a wholly owned subsidiary of Aetna Life & Casualty Company. Appellant Aetna Life Insurance Company has an interest in, but does not wholly own, the following subsidiaries:

CS Development Corporation, East Cactus Plaza Associates, Friday Associates, Koll Center Newport A, Koll Center Newport Number 14, St. Vincents Mall, Village Plaza Associates, Koll Center Newport Number 15, Koll Center Newport Number 8, Koll Center Newport Number 9, Koll Center Newport Number 10, Koll Center Newport Number 11, North Park Plaza Associates, Catalina Plaza, Thace Associates, Lincoln Benicia V, VI & VII Associates, Corporate Center Pasadena Associates, Ensenada De Las Colinas I Associates, Cordova Del-Mar Associates, Hayward Industrial Park Associates V, Tri-City Mall Associates, Aetna Life Insurance Company, Second & Main Associates, Biltmore Fashion Park Associates, Lincoln Center Associates, Chris-Town Village Associates, 1800 West Loop Tower Associates, Edina Office Center Joint Venture, Empire Park Associates, Empire Park IV Associates, Golden State Associates, Hillcrest Associates, Kemble Associates, Lincoln Benicia IV Associates, Meridian Associates, Silverada Mall, Tri Freeways Associates, Tatum Associates, Washington Plaza, Westwood Mall Associates, 1670 Broadway Joint Venture, San Jose V Associates, O'Hare Center Venture, Lincoln Oakland Coliseum I & II Associates, Lincoln San Jose VI Associates, RBA II Associates, Southwest Financial Plaza Annex, Northwest Associates, Royal Commerce Centre Associates, Hayward Industrial Park Associates III, Southwest Financial Plaza, Hayward Industrial Park Associates I, Hayward Industrial Park Associates IV.

Appellant has no other parent company, subsidiary or affiliate within the meaning of Rule 28.1 of the Rules of this Court.

The caption on the December 7, 1984 opinion of the court below, naming Aetna Life & Casualty Co., Inc., as the appellant, should have been corrected by the court below pursuant to its prior grant, on August 29, 1983, of appellant's motion to make that correction as to all papers in that case by naming Aetna Life Insurance Co. as the correct appellant-defendant. Subsequent to the decision below, appellant filed a second motion to ensure that the court below corrects this oversight.

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JURISDICTIONAL STATEMENT

Aetna Life Insurance Co., the appellant, appeals from the final decision of the Supreme Court of Alabama dated December 7, 1984, affirming the judgment of $3,501,650.22 against it by the Circuit Court of Mobile County, the order of the Supreme Court of Alabama dated March 8, 1985, overruling appellant's Application for Rehearing of that December 7, 1984 decision and denying appellant's Motion for Disqualification and Motion for Withdrawal of Opinion of December 7, 1984 and for Hearing De Novo, and the order of that court dated March 25, 1985 denying appellant's Motion to Suspend Rules for the purpose of filing a Second Application for Rehearing. Under this decision and these orders, appellant's right to a fair, unbiased hearing of its appeal guaranteed by the Due Process Clause of the Fourteenth Amndment, as well as appellant's substantive rights under the Contract Clause, the Due Process Clause of the Fourteenth Amendment, and the Excessive Fine Clause of the Eighth Amendment, as made applicable to the States by the Due Process Clause of the Fourteenth Amendment, have been denied. Moreover, § 12-22-72, *Code of Alabama* (1975), under which an automatic penalty of ten percent of the $3,501,650.22 judgment was imposed on appellant upon entry of the December 7, 1984 decision affirming that judgment, has been upheld against appellant's claim that that statute on its face and as applied violates appellant's rights under the Equal Protection Clause of the Fourteenth Amendment.

OPINIONS BELOW

The opinion of the Supreme Court of Alabama of December 7, 1984 is reproduced in App. A, *infra*, 1a-63a, and is unofficially reported in 19 Ala. Bar Rep. 272. The orders, with opinions concurring specially, of the Supreme Court of Alabama of March 8, 1985 are reproduced in App. B, *infra*, 64a-73a, and are unreported. The order of the Supreme Court of Alabama of March 25, 1985 is reproduced in App. C, *infra*, 74a-75a, and is unreported. The prior

opinions of the Supreme Court of Alabama in this case are reported *sub nom. Lavoie* v. *Aetna Life & Casualty Co.*, 374 So.2d 310 (Ala. 1979), and 405 So.2d 17 (Ala. 1981). The Circuit Court of Mobile County issued no opinion.

JURISDICTION

The December 7, 1984 decision and March 8 and 25, 1985 orders of the Supreme Court of Alabama necessarily upheld, *sub silentio*, § 12-22-72, *Code of Alabama* (1975), against appellant's claim, under the Equal Protection Clause of the Fourteenth Amendment, that § 12-22-72 is unconstitutional. Because the judgment and order, App. D, *infra*, 76a, assessing a ten percent penalty against appellant pursuant to this statute was compelled by the December 7, 1984 decision of the Supreme Court of Alabama and was therefore not part of any appealable judgment until that time, appellant's federal constitutional challenge to § 12-22-72 was, pursuant to an unbroken line of sixteen cases decided over a 67-year period by the Supreme Court of Alabama, presented in appellant's Brief and Request for Oral Argument attached to its Application for Rehearing, App. E, *infra*, 81a. A Notice of Appeal of this case to this Court was filed in the court below on March 25, 1985 after appellant had received notice of that court's order in this case of that same date. App. H, *infra*, 282a. This Court has jurisdiction of this case under 28 U.S.C. § 1257(2). Questions 2, 3 and 4 were duly presented to the Supreme Court of Alabama and may be decided with this appeal. *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. 469 (1975).

This appeal is being docketed in this Court within 90 days from the overruling, on March 8, 1985, of appellant's Application for Rehearing.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

1. The Contract Clause, Art. I, § 10, cl. 1 of the Constitution, provides, in pertinent part, that:

> "No State shall . . . pass any . . . Law impairing the Obligation of Contracts . . . ."

2. The Due Process Clause of the Fourteenth Amendment of the Constitution provides, in pertinent part, that:

> "[N]or shall any State deprive any person of . . . property, without due process of law . . . ."

3. The Excessive Fine Clause of the Eighth Amendment of the Constitution, provides, in pertinent part, that:

> "[N]or [shall] excessive fines [be] imposed . . . ."

4. The Equal Protection Clause of the Fourteenth Amendment of the Constitution provides, in pertinent part, that:

> "[N]or shall any State . . . deny to any person within its jurisdiction the equal protection of the laws."

5. Section 12-22-72, *Code of Alabama* (1975), provides, in pertinent part, that:

> "When a judgment . . . is entered . . . for money . . . and the same has been stayed on appeal by execution of bond, with surety, if the appellate court affirms the judgment of the court below, it must also enter judgment against any or all of the obligors on the bond for the amount of the affirmed judgment, 10 percent damages thereon and the costs of the appellate court . . . ."

STATEMENT OF THE CASE

Appellant is before this Court seeking plenary consideration of its contentions that a judgment of $3,501,650.22, including $1,650.22 compensatory damages and $3,500,000 punitive damages, and the $350,165 penalty automatically adjudged on that judgment under § 12-22-72, *Code of Alabama* (1975), have deprived appellant of substantial rights guaranteed by the specific provisions of the Constitution of the United States enumerated above. The constitutional issues presented in Questions 1, 3 and 4 are substantial and in several respects present issues of first impression in this Court.

Appellant recognizes, however, that its constitutional challenge in Question 2 to the fitness of a Justice of the Supreme Court of Alabama to participate in the consideration and decision of this case, as well as the absence of any express determination by the court below of any of the four

federal questions brought to this Court, may tend to divert this Court's attention at this stage of this case, from the substantial federal questions appellant would have preferred to have brought to this Court after a full and constitutionally fair hearing of both the federal constitutional and state law issues in its case by the court below. Therefore, appellant will proceed by first setting forth as briefly as possible those facts pertinent to the constitutional and jurisdictional issues presented by this case, after which the issues of jurisdiction and substantiality will be discussed.

A. Facts Relevant to the Constitutional Questions Presented

In 1977, appellees were insured beneficiaries of a group policy of health and medical insurance issued by appellant to the City of Mobile. On February 3, 1977, appellee Margaret W. Lavoie was admitted to Mobile Infirmary Hospital from which she was discharged 23 days later. App. A, *infra,* 2a-3a.

On June 3, 1977, appellant paid to the appellees, the attending physician and the Infirmary a total of $1,579.74 on a total claim of $3,028.25. Appellant declined to pay for other charges, stipulated to be $1,650.22, App. A, *infra,* 6a, on the basis of the assessment (later rejected by the trial court) that the latter amount was incurred for "care, treatment, services or supplies which are not necessary for the treatment of the . . . disease concerned . . . ." and therefore was not within its contractual obligation to appellees. App. A, *infra,* 11a. On November 14, 1977, December 23, 1977 and August 3, 1978 appellant again declined to pay the outstanding balance of the claim. App. A, *infra,* 8a-10a. At all relevant times through August 3, 1978, Alabama did not recognize a cause of action for bad faith failure to pay an insurance claim in the first party context.

Fully consistent with the state of the pertinent law in Alabama at the time, the circuit court initially dismissed appellees' civil action for failure to state a claim for relief pursuant to Rule 12(b)(6) of the Alabama Rules of Civil Procedure. *Lavoie* v. *Aetna Life & Casualty Co.,* 374 So.2d 310, 310-11 (Ala. 1979). The Supreme Court of Alabama

reversed on August 31, 1979, stating that it had "neither accepted nor rejected" a theory of recovery based on "bad faith refusal of the insurer to pay legitimate benefits due under a policy of insurance." *Id.*, at 311.

On October 2, 1981, the Supreme Court of Alabama held, for the first time, that a cause of action for bad faith failure to pay an insurance claim existed in Alabama. *Chavers* v. *National Security Fire & Casualty Co.*, 405 So.2d 1 (Ala. 1981). As stated by the dissenting Justice in that case, "Today the Court . . . introduces you to Mr. Bad Faith." *Id.*, at 15 (Almon, J. dissenting).

That same day, the Supreme Court of Alabama reversed the circuit court's decision granting summary judgment for appellant on the two bad faith counts in this case, *Lavoie* v. *Aetna Life & Casualty Co.*, 405 So. 2d 17 (1981), and remanded the case to the circuit court "in light of" its "recent decision . . . recogniz[ing] the intentional tort of bad faith in first party insurance actions." *Id.*, at 18.

In yet another case handed down on October 2, 1981, the Supreme Court of Alabama decided that under the newly recognized tort of bad faith, punitive damages would be recoverable. *Gulf Atlantic Life Insurance Co.* v. *Barnes*, 405 So.2d 916, 925 (Ala. 1981).

In 1982, this "Dr. Frankenstein's monster," *Chavers* v. *National Security Fire & Casualty Co.*, 405 So.2d, at 14 (Almon, J., dissenting), took on additional form when the Supreme Court of Alabama held that, as a general rule, a bad faith claim would not be recognized unless the plaintiff is "entitled to recover on the contract claim *as a matter of law.*" *National Savings Life Insurance Co.* v. *Dutton*, 419 So.2d 1357, 1362 (Ala. 1982) (emphasis added). That same year, the court also reaffirmed its view that, as a general matter, partial payment of a claim, as occurred in this case, would take "away the issue of bad faith refusal to pay." *National Security Fire & Casualty Co.* v. *Bowen*, 417 So.2d 179, 186 (Ala. 1982). *See also Sexton* v. *Liberty National Life Insurance Co.*, 405 So.2d 18 (1981).

On November 4, 1982, the jury returned with a verdict against appellant in the amount of $3,501,650.22, of which

$3,500,000 was for punitive damages. On September 8, 1983 appellant filed its opening brief in the Supreme Court of Alabama.[1] On November 17, 1983, the request of appellant and appellees for oral argument was denied by the court below and the case was submitted to a division of the court.

On November 23, 1983 Justice T. Eric Embry of the Supreme Court of Alabama gave notice to the Maryland Casualty Company of the loss of a valuable mink coat from his home, the loss of which he alleged to be covered by an insurance policy written by that company. App. F, *infra*, 90a. In a civil action against Maryland Casualty Co. filed by Justice Embry on January 19, 1984, Justice Embry alleged that the defendant insurance company "in bad faith, willfully, intentionally, and/or maliciously failed to pay a valid claim" and prayed for "punitive damages." App. F, *infra*, 91a.

On January 30, 1984, Justice Embry filed a civil action on behalf of himself and as representative of a class of all other Alabama state employees insured under a group plan by Blue Cross-Blue Shield of Alabama ("Blue Cross") alleging, *inter alia*, a failure of Blue Cross to pay in full various claims for him and his late wife, a custom of paying in claims only a portion of the actual charges, unreasonable delay in paying claims, and a "conscious, willful and intentional and fraudulent plan or scheme [to withhold] payment of valid claims for unreasonable lengths of time and in so doing, [to] unlawfully enrich . . . itself . . . ." (App. F, *infra*, 98a. The complaint alleged bad faith and sought punitive damages. App. F, *infra*, 102a.

On April 4, 1984, the court below set aside its previous denial of the requests for oral argument in this case and set the case for oral argument. On May 14, 1984 the pending case was argued and submitted to the full court.

On December 7, 1984, Justice Embry, despite his ongoing involvement in the lawsuit against Blue Cross (his suit

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[1] A copy of the docket entries in this case in the court below is being lodged with the Clerk of this Court simultaneously with the docketing of this appeal.

against the Maryland Casualty Co. having settled, App. F, *infra*, 85a), participated as the fifth Justice necessary to the majority position in the 5-4 affirmance of the $3,501,650.22 judgment against appellant. In the per curiam opinion joined by Justice Embry and four other Justices, the court below, for the first time in any bad faith case, renounced its 1982 position in *Dutton* and held inapplicable its own general rule that a plaintiff must be entitled to judgment as a matter of law on the contract claim in order for a bad faith action to go to a jury, App. A, *infra*, 25a-31a. Also for the first time, and contrary to its 1981 position in *Sexton* as reaffirmed in 1982 in *Bowen*, the Supreme Court of Alabama held inapplicable the general rule that partial payment would defeat a bad faith claim, App. A, *infra*, 32a-33a. On December 21, 1984 appellant filed a timely Application for Rehearing.

On January 10, 1985, while appellant's Application for Rehearing in this case was *sub iudice* in the court below, Justice Embry was deposed by Blue Cross. App. G, *infra*, 145a. In that deposition, Justice Embry, *inter alia*: (1) acknowledged his authorship of the December 7, 1984 per curiam opinion in this case, App. G, *infra*, 169a; (2) discussed facts regarding the internal deliberations of the court below in this case, App. G, *infra*, 166a-170a; (3) discussed his involvement in development and prosecution of his case against Blue Cross at the same time he was drafting the opinion in this case, App. G, *infra*, 206a-207a, 228a; and (4) made statements regarding his personal experiences over many years with alleged non-payment, partial, and late payment of health insurance and other insurance claims. App. G, *infra*, 173a *et seq.*

On February 14, 1985 appellant first learned of Justice Embry's pending suit against Blue Cross, and on February 21, 1985 appellant filed two motions raising its disqualification challenge in the court below. App. F, *infra*, 85a. On March 8, 1985 Justice Embry participated in the denial of appellant's two disqualification motions and its Application for Rehearing. App. B, *infra*, 64a-65a. On March 20, 1985 appellant received a copy of the January 10, 1985 deposition

and on March 22 moved once again for his disqualification, App. G, *infra,* 132a. On March 25, 1985, Justice Embry participated in the denial of appellant's motion. App. C, *infra,* 75a.

B. The Federal Questions Were Properly Presented

This Court has recently had occasion to restate the familiar rule that it will not normally assume jurisdiction over a case and consider a federal question presented by that case unless that federal question "had been *either* raised or squarely considered and resolved in state court." *Illinois* v. *Gates,* 462 U.S. 213, 218 n.1 (1983). Because the four federal questions presented by appellant in this appeal were not *expressly* "considerely and resolved" by the court below, appellant recognizes that it has the burden of persuading this Court that it has jurisdiction over this appeal and that there is no jurisdictional or prudential bar to this Court's deciding each of the four questions presented.

The orders of the court below denying appellant's motions regarding the disqualification question facially preclude a determination that appellant's constitutional challenge to Justice Embry's fitness (Question 2) could have been denied on an independent and adequate state ground. Thus, the discussion of the presentation of that issue requires no explication of appellate practice in Alabama. For that reason, appellant will address the presentation of Question 2 first even though the disposition of Question 2 by the court below lies, as a technical matter, within this Court's *certiorari* jurisdiction under 28 U.S.C. § 1257 (3) rather than this Court's appellate jurisdiction under 28 U.S.C. § 1257(2). *See* 28 U.S.C. § 2103. Appellant will then discuss the presentation of Questions 1, 3 and 4 in the fuller context of the relevant Alabama practice.

1. Presentation of the Disqualification Issue

Question 2 regarding the disqualification of Justice Embry and appellant's demand under the Due Process Clause for hearing de novo of its case was undoubtedly presented properly to the Supreme Court of Alabama. On or about

February 14, 1985 while appellant's case was pending before that court, appellant learned that Justice Embry had filed and was still prosecuting a class action for bad faith failure to pay insurance claims against Blue Cross. App. F, *infra*, 86a. After a brief but necessary factual inquiry, on February 21, 1985 appellant filed in the Supreme Court of Alabama its two disqualification motions. Appellant's challenge was also directed to the other eight Justices of the court below on the basis of appellant's assumption (confirmed, at least in part, by the opinions specially concurring in the March 8, 1985 order) that each Justice was probably insured under the same Blue Cross contract and each was therefore probably a member of the putative class which Justice Embry sought to represent.[2]

Paragraphs 8, 9 and 10 of appellant's February 21, 1985 motions clearly stated that appellant was asserting, *inter alia*, rights under the "Due Process Clause of the Fourteenth Amendment of the Federal Constitution," App. F, *infra*, 87a, and that Justice Embry's participation in the consideration and decision of this case violated appellant's federal due process rights and required a hearing de novo of appellant's case after appointment of a qualified court pursuant to § 12-2-14, *Code of Alabama* (1975).[3] App. F,

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[2] Appellant does not bring to this Court the question whether the membership of the eight other Justices of the Supreme Court of Alabama in the putative class in Justice Embry's civil action against Blue Cross is or was, in and of itself, sufficient to disqualify those Justices under the Due Process Clause of the Fourteenth Amendment from future participation in this case on remand from any judgment of this Court. As indicated by the opinions issued by Chief Justice Torbert and Justice Maddox specially concurring in denial of appellant's February 21, 1985 motions related to disqualification. App. B, *infra*, 66a (Torbert, C.J., specially concurring), 69a (Maddox, J., specially concurring), both of those Justices took action to withdraw as members of that putative class, and appellant is prepared to assume that the remaining Justices will also withdraw in due course if further proceedings in the court below are required by this Court's ultimate disposition of this case.

[3] Under this statute, the Governor of Alabama is authorized specially to appoint temporary Justices to the Supreme Court of Alabama from the membership of the state bar in cases in which the disqualification of

(footnote continued)

infra, 88a. Appellant's February 21 Motions and its Application for Rehearing were denied on March 8, 1985. App. B, *infra*, 64a.

On March 20, 1985, appellant obtained for the first time a copy of the transcript of Justice Embry's January 10, 1985 deposition. App. G, *infra*, 133a. That deposition contained previously unobtainable information regarding Justice Embry's qualifications to hear and decide appellant's case. On March 22, 1985 appellant renewed its challenge to Justice Embry's qualifications in its Motion to Suspend Rules, placing the transcript of Justice Embry's deposition before the court and giving that court a second opportunity to pass on that question.

As reflected in the March 8, 1985 order, per curiam opinion, and opinions specially concurring in that order, App. B, *infra*, 64a-73a, each and every Justice of the court below clearly decided appellant's challenge to his or her individual fitness to sit in this case. These "individual" decisions on the merits necessarily preclude the argument that this federal constitutional challenge was disposed of on an independent and adequate state ground. That per curiam opinion stated:

> "The Court is of the opinion that under the allegation of said motion in this case each justice should vote individually on the matter of whether or not he or she is disqualified and should recuse. Each justice having voted not to recuse, IT IS THEREFORE, ORDERED that the [appellant's motions] be . . . denied."

App. B, *infra*, 64a.

It is indisputable on the face of this terse order and opinion that "the Court" reached and decided a procedural aspect of appellant's disqualification challenge, *i.e.*, whether an individual Justice should or would pass on the qualifications of the other individual Justices to hear and decide this case, and a substantive issue, *i.e.*, that each of

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one or more Justice(s) leaves an even number (six or eight) of Justices available to hear and decide a case and there is an equal division among them or the number of available Justices is reduced below six.

the five Justices who joined this per curiam opinion also individually determined himself or herself not to be disqualified. Therefore, Question 2 is properly before this Court.

Even if the federal constitutional question is assumed not to have been decided by the court below, under this Court's cases, refusal by a state court to *decide* a properly presented federal question which was necessary to the state court's disposition of the case before it, *see generally NAACP* v. *Alabama*, 377 U.S. 288 (1964), is similar in effect to a state court's silence on a federal question; neither operates to defeat this Court's jurisdiction. As Chief Justice Marshall expressed this principle, all that is required is that "the record should show a complete title under the [federal law invoked], and that the judgment of the [state] court is in violation" of that federal law. *Hickie* v. *Starkie*, 26 U.S. (1 Pet.) 72, 75 (1828); *Illinois* v. *Gates*, 462 U.S., at 220 n.2. Thus, the denial of appellant's disqualification motions had the legal effect of denying appellant's asserted rights under the Due Process Clause of the Fourteenth Amendment, and the curious manner in which the court below disposed of those motions has no affect on this Court's jurisdiction over this case and its power to decide Question 2. *See generally New York ex rel. Bryant* v. *Zimmerman*, 278 U.S. 63, 67-68 (1928).

2. Presentation of the Federal Constitutional Challenge to § 12-22-72, *Code of Alabama* (1975)

Question 1 involving the facial unconstitutionality of § 12-22-72, *Code of Alabama* (1975), was presented for the first time in appellant's Brief filed with its Application for Rehearing.[4] App. E, *infra*. 81a. This was the logical time for appellant to present its challenge to § 12-22-72's con-

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[4] Under Rule 20, Ala. R. App. P., "Assignments of error are not required. Statement of the issues presented on appeal in the appellant's brief as required by Rule 28 shall be sufficient." This Court has expressly relied upon presentation in briefs before the Supreme Court of Alabama

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stitutionality, since the non-discretionary imposition by the court below of the ten percent penalty on the $3,501,650.22 judgment was not at issue or reduced to any appealable order until that judgment was affirmed.

Appellant's challenge to § 12-22-72 was properly and timely presented in complete conformity with relevant decisions of the Supreme Court of Alabama—a line of at least sixteen cases dating from 1918, in which the federal constitutionality of, or questions regarding the construction of, § 12-22-72 have been drawn into question. In one such case, § 12-22-72 was challenged under the Equal Protection Clause for the first time in an Application for Rehearing in the Supreme Court of Alabama. Without any suggestion that raising the issue at that stage was in any way improper or inconsistent with Alabama practice, the Supreme Court of Alabama, consistent with its routine practice,[5] entertained (and rejected) the federal constitutional challenge to § 12-22-72 on the merits. *Central of Georgia Railway Co.* v. *Steed*, 287 Ala. 64, 76-77, 248 So.2d 110, 120-21 (1979). In light of this longstanding and consistent practice, the action of the court below in overruling appellant's Application for Rehearing without any opinion must be deemed by this Court as having implicitly upheld the con-

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in finding that a federal question was properly presented. *NAACP* v. *Alabama*, 377 U.S. 288, 293 n.4 (1964).

[5] The Supreme Court of Alabama has routinely permitted constitutional and statutory questions regarding § 12-22-72 to be raised in an Application for Rehearing or an equivalent post-judgment motion. *See Brown Mech. Contractors, Inc.* v. *Centennial Ins. Co.*, 431 So.2d 932 (Ala. 1983); *First Alabama Bank of Montgomery, N.A.* v. *Martin*, 425 So.2d 415 (Ala. 1983); *Chapman* v. *Rivers Constr. Co.*, 284 Ala. 633, 227 So.2d 403 (1969); *City of Troy* v. *McLendon*, 279 Ala. 553, 188 So.2d 281 (1966); *Goodyear Tire & Rubber Co.* v. *Downey*, 266 Ala. 344, 96 So.2d 278 (1957); *Patterson* v. *Gains*, 264 Ala. 184, 85 So.2d 893 (1956); *Lloyd* v. *Stewart*, 258 Ala. 627, 64 So.2d 884 (1953); *Childress* v. *Younger*, 258 Ala. 219, 61 So.2d 808 (1952); *City of Birmingham* v. *Bowen*, 254 Ala. 41, 47 So.2d 174 (1950); *Atlanta, Birmingham & Coast R. Co.* v. *Cary*, 250 Ala. 675, 35 So.2d 559 (1948); *Carter* v. *Carter*, 247 Ala. 409, 24 So.2d 759 (1945); *Snellings* v. *Builders' Supply Co.*, 229 Ala. 1, 155 So.

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stitutionality of § 12-22-72; that action was presumptively not based on lack of proper presentation of this question.[6]

3. Presentation of Questions 3 and 4

Question 4 was presented for the first time in appellant's Brief in support of its Application for Rehearing by express reference to the Excessive Fine Clause of the Eighth Amendment and the Due Process Clause of the Fourteenth Amendment. App. E, *infra*, 79a-80a. This question was also brought before the court below in appellant's disqualification motions filed February 21, 1985, App. F, *infra*, 87a, and March 22, 1985, App. G, *infra*, 272a.

Question 3 was also presented in the Brief in support of appellant's Application for Rehearing. App. E, *infra*, 79a-80a. Although the Contract Clause was not specifically cited until the filing of appellant's motions of February 21, 1985, App. F, *infra*, 87a, the substantive argument made on February 21 is indistinguishable from the Brief's constitutional challenge to the $3,500,000 award based on retroactive application of new legal rules and therefore was nothing more than "an enlargement of the one mentioned" in its Brief in support of its Application for Rehearing and may be viewed as "so connected with it in substance as to form but another ground or reason for alleging the invalidity" of the December 7, 1984 judgment. *Dewey* v. *Des Moines*, 173 U.S. 193, 197-98 (1899). *See generally Illinois* v. *Gates*, 462 U.S., at 219-20; *id.*, at 248-50 (White, J., concurring in the judgment); *Stanley* v. *Illinois*, 405 U.S. 645, 658 n.10 (1972).

On the extraordinary facts of this case, appellant's assertion of these two federal constitutional questions after

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858 (1934); *Dent* v. *Foy*, 210 Ala. 160, 97 So. 627 (1923); *Montgomery Light & Water Power Co.* v. *Thombs*, 204 Ala. 678, 87 So. 205 (1920); *New York Life Ins. Co.* v. *Reese*, 201 Ala. 673, 79 So. 245 (1918).

[6] The only rule of appellate procedure directly relevant to appellant's challenge to the constitutionality of § 12-22-72 is Rule 44, Ala. R. App. P., which requires that the Attorney General of Alabama be served with a copy of the "written brief" raising the constitutional challenge. Appellant complied with this Rule. App. E, *infra*, 84a.

the December 7, 1984 decision of the Supreme Court of Alabama was and is justified on five separate grounds. Before setting forth these five grounds, appellant will first discuss two more general aspects of the proper presentation question.

a. The Presentation of Questions 3 and 4 Raises Only Prudential Concerns

This Court's decisions addressing the question of proper presentation of federal questions to state courts for purposes of this Court's subsequent consideration of such federal questions has left unclear whether and when the rules formulated by this Court are jurisdictional, as opposed to prudential. Appellant submits that once this Court has jurisdiction over a case because one federal question has been properly presented to, or decided by, the state court below, then this Court's *power* to decide other federal questions in that case cannot be subject to serious question. The jurisdictional statutes applicable to this case, 28 U.S.C. § 1257(2) & (3), confer jurisdiction over "[f]inal judgments or decrees" where the validity of "*a* statute" has been drawn into question or where "*any* title, right, privilege or immunity is specially set up or claimed . . . ." (emphasis added).

Consistent with the plain language of the relevant statutes, this Court's classic formulation is that dismissal of an appeal is required in the "total absence . . . of *any* question . . . which would give this court jurisdiction." *Crowell* v. *Randell*, 35 U.S. (10 Pet.) 240, 263 (1836) (emphasis added). Appellant submits that this Court, because it has jurisdiction over cases, not questions, has clear jurisdiction over this case based upon Questions 1 and 2 and that its consideration and decision of Questions 3 and 4 should be viewed, analytically, as raising only prudential considerations.

b. Alabama's Rules Did Not Preclude Presentation After the Court's December 7, 1984 Decision

Neither the Alabama Rules of Civil Procedure nor the Alabama Rules of Appellate Procedure facially precluded

the presentation of Questions 3 or 4 after the announcement of the December 7, 1984 opinion, nor did those rules preclude the court below from reaching and deciding these questions when they were presented.

No rule of the Alabama Rules of Civil Procedure *expressly* addresses the issue of presentation of federal, or even state, *constitutional* questions in the trial court. In contrast to review by the Supreme Court of Alabama by certiorari of decisions of Alabama's intermediate appellate courts, Rule 39, Ala. R. App. P., under which the intermediate appellate court must have overruled an application for rehearing on the point on which further discretionary review on certiorari is sought, there is no comparable rule governing appeals of right from the circuit (trial) courts. It is also clear that the court below does, as a matter of its own practice, entertain and decide constitutional questions raised for the first time in an Application for Rehearing. *See, e.g., Central of Georgia Railway Co.* v. *Steed*. 287 Ala. 64, 76-77, 248 So.2d 110, 120-21 (1971). And, notwithstanding the fact that the court below has stated from time to time that "it is well established that where a constitutional question was not raised on trial it will not be considered on appeal . . . ," *City of Montgomery* v. *Robinson*, 441 So.2d 857, 861 (Ala. 1983), the court's practice has been to proceed to rule on such questions. *Id. See King* v. *Reid*, 428 So.2d 611, 615 (Ala. 1983); *Ex parte Hanna*, 267 Ala. 527, 103 So.2d 720 (1958).

Thus, under these circumstances an express ruling by the court below denying appellant's Application for Rehearing on procedural grounds would not have extinguished this Court's power to decide these federal constitutional questions under this Court's decision in *Barr* v. *City of Columbia*, 378 U.S. 146, 149 (1964), which requires that procedural barriers to consideration of federal questions be "strictly or regularly followed" in order to deprive this Court of power to review substantial federal constitutional questions. There was, of course, no such express ruling below.

c. Prudential Considerations

Because there is no independent and adequate state ground for the denial of appellant's Application for Rehearing, appellant need only convince this Court that there are no additional prudential barriers to its consideration of Questions 3 and 4. None of the prudential considerations discussed in this Court's recent decision in *Illinois* v. *Gates* are preclusive here.

First, if this Court's ultimate decision on Question 2 were in appellant's favor, then, *a fortiorari,* appellant would never have had "a reasonable opportunity to have the issue[s] as to the claimed right[s] heard and determined" by the Supreme Court of Alabama. *See Central Union Tel. Co.* v. *Edwardsville,* 269 U.S. 190, 194-95 (1925). In such circumstances, there would be ample precedent for this Court's proceeding to the merits of Questions 3 and 4. *See, e.g., NAACP* v. *Alabama,* 377 U.S., at 302. especially since Justice Embry's disqualification would bring into play the provisions of § 12-2-14, *Code of Alabama* (1975), resulting in the appointment of one or more temporary Justices to hear this case. In such circumstances, there is nothing to be said, either as a matter of comity or judicial economy, for remanding these important federal constitutional questions for decision on the merits by a court with one or more provisional members.

Second, appellant could not reasonably have been expected to anticipate that the Supreme Court of Alabama would so dramatically affect its constitutional rights by substantially modifying, by the margin of a single, highly interested vote, at least two relatively firm and recently established substantive standards governing the award of punitive damages in Alabama. *See Brinkerhoff-Faris Trust Co.* v. *Hill,* 281 U.S. 673, 677-78 (1930). Appellant, in its Brief in support of its Application for Rehearing, specifically brought to the attention of the court below these two substantial modifications in the legal rules governing the tort of bad faith failure to pay an insurance claim. App. E, *infra,* 79a-80a. Thus, appellant's presentation of its Contract Clause claim in its Application of Rehearing was

appropriate both under *Brinkenhoff-Faris* and because the court below has a practice of entertaining constitutional questions which arise as a result of its own decision in a case, as in *Central of Georgia Railway Co.* v. *Steed, supra.*

Furthermore, it is apparent from the face of the per curiam opinion below that the $3,500,000 punitive damage award challenged in Questions 3 and 4 was based, at least in part, on the totally unexpected and unwarranted purported "findings" in the per curiam opinion that appellant was guilty of "fraudulent" conduct, App. A, *infra,* 22a, 35a, 36a & 37a, notwithstanding the fact that a fraud count brought by appellees had been withdrawn prior to trial. Similarly, the per curiam opinion contains an equally unexpected and unwarranted purported "finding" that appellant had been engaged in a "conspiracy," App. A, *infra,* 33a, 35a, even though conspiracy counts had likewise been brought by appellees but had been withdrawn at the close of the appellees' case.[7] Under the circumstances, appellant could not reasonably have anticipated that such "findings" would be used against it by the court below. Thus, appellant's constitutional challenges to the $3,500,000 punitive damages award are timely under this Court's decision in *Saunders* v. *Shaw,* 244 U.S. 317 (1917).

Third, in a case in which this Court has clear appellate jurisdiction over one question and equally clear jurisdiction over a substantial constitutional challenge to the fairness of the hearing in the court below, "due regard for the appropriate relationship of this Court to state courts." *McGoldrick* v. *Campagnie Generale Transatlantique,* 309 U.S. 430, 434 (1940), carries much less force than it might otherwise.

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[7] Appellant is lodging with the Clerk of this Court simultaneously with the docketing of this appeal copies of the page of the official transcript of this case in the trial court in which counsel for appellees acknowledged having withdrawn the conspiracy counts, and also copies of that portion of appellee's Amended Complaint in which a fraud count was plead as the Sixth Cause of Action and the full Second Amended Complaint, which did not plead a fraud count.

Fourth, Questions 3 and 4 do not depend for their resolution on development of any facts beyond those which have already been developed in this case. Thus, this Court would in no way benefit from further development of any facts in this case, nor would the Supreme Court of Alabama have benefitted from a fuller record if it had granted appellant's Application for Rehearing. *See generally Illinois* v. *Gates*, 462 U.S., at 221.

Fifth, this Court's ultimate resolution of Questions 3 and 4 may well turn on its decision with respect to substantial issues of first impression in this Court upon which the views of the court below would not necessarily have been illuminating. The highest court of a State is not well situated to decide the question whether the Contract Clause is applicable to its creation of common law obligations. And, as discussed *infra*, past decisions of this Court have contained broad language to the effect that only state statutes—as opposed to the judgments of state courts—are susceptible to challenge under the Contract Clause. There is little, if anything, to be said for requiring appellant to present to the court below, beyond the efforts already made by appellant, arguments which directly challenge broad dicta in cases of this Court such as *Tidal Oil Co.* v. *Flanagan*, 263 U.S. 444 (1924) (Contract Clause not applicable to judicial action), discussed *infra*, pp. 26-28, by which the court below might appropriately have regarded itself as bound. *See Illinois* v. *Gates*, 462 U.S., at 251 (White, J., concurring in the judgment).

C. The Questions Are Substantial

1. The Unconstitutionality of § 12-22-72, *Code of Alabama* (1975)

Under § 12-22-72, *Code of Alabama* (1975), defendant-appellants, like appellant here, are subjected to an automatic, non-discretionary ten percent penalty, payable to the appellee, upon affirmance of a money judgment, even where the issues are novel, are so complex and open to dispute that they divide the state's highest appellate court almost evenly, and can be decided against the appellant

only by substantially modifying or reversing two recent precedents of that appellate court.

If § 12-22-72 is designed to prevent frivolous appeals, it is manifestly overinclusive and unreasonably severe. At the same time, it is irrationally underinclusive because plaintiff-appellants suffer no penalty for taking an utterly frivolous appeal. Appellant will argue to the Court that this statute, which appears to exist in the same non-discretionary form in only one other State,[8] is irreconcilable with, and therefore must be struck down under, this Court's decision in *Lindsey* v. *Normet*, 405 U.S. 56 (1972).

In *Lindsey*, this Court recognized that "a State may properly take steps to insure that an appellant post adequate security before an appeal to preserve the property at issue, to guard a damage award already made, or to insure a landlord against loss of rent if the tenant remains in possession [during the pendency of the appeal] . . . ." 405 U.S., at 77. However, this Court unanimously struck down as "arbitrary and irrational," *id.*, at 79, the Oregon statute in issue which, notwithstanding adequate statutory protections to secure the fruits of a lower court victory, *id.*, at 77-78,[9] required a specific class of defendants, tenants, to post a double bond in order to appeal from a judgment in favor of landlords. Under the Oregon statute, if the lower court judgment were affirmed on appeal, the landlord would be "automatically entitled to twice the rents accruing during the appeal without proof of actual damage . . . ." *Id.*, at 76. Nor did the double-bond requirement discourage

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[8] In *Wallace* v. *Jones*, 360 So.2d 932 (Miss. 1978), the Supreme Court of Mississippi rejected a federal constitutional challenge to a post-judgment motion for assessment of a statutory, mandatory five percent penalty against the appellant-defendant in that case.

[9] Under Rule 38, Ala. R. App. P., both plaintiffs and defendants who take appeals in civil cases are treated in an even-handed manner as regards the *damages* and *costs* incurred in defending a judgment that is appealed either by plaintiffs or defendants where the judgment below is affirmed and the appeal is determined to have been frivolous. This rule, in sharp contrast to § 12-22-72, adequately fulfills the legitimate state purpose of curbing abuse of the right to appeal and serves to accentuate the arbitrariness of § 12-22-72.

all frivolous appeals. *Id.*, at 78. Under § 12-22-72, *Code of Alabama* (1975), successful plaintiff-appellees likewise receive a ten percent windfall totally unrelated to any costs they might have incurred, or damages they might have suffered, and plaintiff-appellants are free to take whatever frivolous appeals they wish.

As the *Lindsey* Court stated, a State may act "to discourage patently insubstantial appeals . . . if [its] rules are *reasonably tailored to achieve these ends* and if they are *uniformly and nondiscriminatorily* applied." 405 U.S., at 78 (emphasis added). Section 12-22-72 fails all these tests.

2. The Disqualification Question

In *Withrow* v. *Larkin*, 421 U.S. 35, 46-47 (1975), this Court unanimously reaffirmed the principle, articulated three decades ago by Justice Black for this Court, that:

> "A fair trial in a fair tribunal is a basic requirement of due process. Fairness of course requires an absence of actual bias in the trial of cases. But our system of law has always endeavored to prevent even the probability of unfairness. To this end no man can be a judge in his own case and no man is permitted to try cases where he has an interest in the outcome."

In re Murchison, 349 U.S. 133, 136 (1955).

It is inconceivable that this *constitutional* principle is not fully applicable to the proceedings of the Supreme Court of Alabama. If it is, then the gravity and substantiality of Question 2, presented to this Court by appellant only after strenuous attempts to have it resolved by the court below, are self-evident.

The essential facts relative to the actions of Justice Embry believed by appellant to disqualify him under the Due Process Clause to have heard appellant's case below are matters of public record. Some of these facts are set forth *supra*, pp. 6-7, and need not be recounted here. The identity between the issues raised in Justice Embry's civil action against Blue Cross and the issues decided by Justice Embry and his four colleagues is obvious and startling. Indeed, the two issues on which the decision below made

substantial new Alabama law, discussed *supra*, pp. 5-7, were directly related to and could predictably resolve in his favor the claims advanced in Justice Embry's Blue Cross case.[10]

In addition to those facts, which of themselves are sufficient to create a substantial constitutional cloud over Justice Embry's participation in this case, the connection between the complaint filed by Justice Embry and the per curiam opinion in this case (written by Justice Embry) is inescapable. In his complaint, Justice Embry alleged conduct by the defendant to be, *inter alia*, "fraudulent," App. F, *infra*, 98a (¶ 6 & 6(d)), a term that appears no fewer than four times in the per curiam opinion below notwithstanding the fact that a fraud count was brought against appellant in this case but was withdrawn prior to trial. And, as pointed out above, the per curiam opinion authored by Justice Embry appears to have "found" appellant guilty of a "conspiracy" even though the conspiracy counts in the case had been withdrawn during trial. Furthermore, in his complaint Justice Embry squarely attacks alleged bad faith *partial* payments. App. F, *infra*, 101a-102a (¶¶ 12 (e), 13). In the case below, the Supreme Court of Alabama held for the first time, overriding its own recent precedent, that partial payment was not a bar to a bad faith cause of action.

Even if the facts were not so overwhelming, the mere potential that the opinion issued by the court below in this case could control or influence the disposition of Justice Embry's claims, standing alone, presents a substantial constitutional question as to appellant's right to a judicial forum free of such a strong appearance of unfairness.

Finally, as demonstrated by the transcript of a deposition given by Justice Embry in his civil action on January

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[10] The appellant's argument would be the same even if Justice Embry's vote in this case had not been the decisive vote, because the participation of Justice Embry in the *consideration* of this case would necessarily taint the entire consideration of this case at least from the day Justice Embry filed his first bad faith civil action.

10, 1985,[11] at the very time that appellant's Application for Rehearing was pending in the court below, Justice Embry discussed aspects of appellant's case in the context of his own case. By this action he not only pierced the veil of confidentiality universally accorded deliberations of appellate courts, but also provided direct evidence of the inappropriateness of his participation in the consideration of this case.

In his deposition, Justice Embry was asked whether, in his civil action against the Maryland Casualty Co., he had sued for bad faith. His response was: "Yeah, sure as hell did. Got that fee." When asked whether that suit had been filed as a class action, Justice Embry responded: "No, no. They just goofed up like the casualty companies do, and other companies." App. G, *infra*, 166a.

Justice Embry went on in that deposition to acknowledge that he authored the per curiam opinion in this case below, App. G, *infra*, 167a, over an "eight or nine" month period in 1984, App. G, *infra*, 168a, during which his civil action against Blue Cross was being prosecuted. He also acknowledged that his opinion began as a dissenting opinion but became the majority opinion in "about November, December of this past year [1984]." App. G, *infra*, 169a.

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[11] As discussed in appellant's Motion for Stay of Execution of Judgment filed in the court below on March 22, 1985, appellant and its counsel below were unable to secure a transcription of Justice Embry's deposition, despite their best efforts to do so, until March 20, 1985, and therefore were unable to ascertain its actual contents and relevance to appellant's motions filed on February 21, 1985 until after those motions had been denied on March 8, 1985. Under Rule 30(f), Ala.R.Civ.P., transcriptions of depositions, once filed with the appropriate court, are part of the court record and are available to members of the general public unless sealed pursuant to a court order issued under the authority of Rule 26(c), Ala.R.Civ.P. No such order was issued with respect to this deposition. The transcript of Justice Embry's deposition was attached as an exhibit to, and incorporated into, appellant's Motion for Suspension of Rules and Motion for Stay of Execution of Judgment filed on March 22, 1985 and is therefore part of the record in this case below for purposes of this Court's taking notice of it. Appellant lodged a copy of the complete transcript with its Application for Stay in this Court on March 25, 1985, and the transcript is reproduced *in toto* in App. G, *infra*, 145a-265a.

When asked whether he had had "any difficulty with processing [insurance] claims" prior to October 1, 1982, Justice Embry responded: "[T]hat is a silly question. For years and years." App. G, *infra*, 173a. With reference to the class action aspect of his civil action, Justice Embry was asked about information he might have received "concerning the allegations" in his complaint, to which he responded: "I got leads from people that I put [my attorney] in touch with." App. G, *infra*, 206a-207a. Later, Justice Embry stated that he had been contacted since the filing of his civil action by "[n]umerous [people who] have read about the lawsuit and read some of the details and said that is typical of the way [they] have been treated . . . ." App. G, *infra*, 228a. All of these contacts occurred while this case was *sub judice* in the court below.

The only reasonable reading of the transcript of Justice Embry's deposition is that at least from the time he first threatened to file a case against Blue Cross for "tortious bad faith," App. G, *infra*, 247a-248a, he harbored strong sentiments regarding claims practices of insurers. He has been deeply and personally involved in litigation raising the very issues on which he was simultaneously enmeshed in drafting the opinion below and in persuading (successfully) a majority of his colleagues to concur in his views.

There is no need for a trial on the merits of the facts related to this question. The documents of record in the State of Alabama discussed above, like the affidavit relied on by this Court in *Berger* v. *United States*, 255 U.S. 22, 32-36 (1921), to disqualify Judge Kenesaw Mountain Landis on the basis of personal bias, sufficiently demonstrate a personal bias on the part of Justice Embry against appellant and similarly situated insurance companies, and a personal interest in both the outcome of, and resolution of, points of law in this case below to require his disqualification under the Due Process Clause of the Fourteenth Amendment if this Court continues to embrace the tenets of *In re Murchison*, as it did only a decade ago in *Withrow* v. *Larkin*, 421 U.S., at 46-47.

3. The Contract Clause Question

The Supreme Court of Alabama has purported retroactively to alter the obligations under a contract in effect in 1977 with respect to liabilities under that contract for actions occurring in 1977 and 1978. Principally, it has added the substantive obligations articulated in 1981 in *Chavers* v. *National Security Fire & Casualty Co.*, 405 So.2d 1 (Ala. 1981), upon pain of the infliction of substantial, arbitrary and unpredictable punitive damages. This drastic obligation was not recognized by Alabama either legislatively or judicially until October 5, 1981. Since 1981, this obligation has undergone further substantial substantive modifications up to and including the decision in this case, all of which were imposed, long *post hoc*, on appellant's consensual contractual relationship with appellees and, in theory, similar contractual relationships between appellant and all of its insureds in Alabama even though appellant calculated premiums, entered into contracts, and established reserves on the premise of a drastically different state of the law as existed prior to October 5, 1981.

In *Allied Structural Steel Co.* v. *Spannaus*, 438 U.S. 234 (1978), this Court struck down as unconstitutional under the Contract Clause a Minnesota statute which had imposed, retroactively, on the Allied Structural Steel Co. ("Allied") the obligation to make certain additional payments under the contract governing the pension plan maintained by Allied for its employees.

In holding that Minnesota statute unconstitutional, this Court made clear that while the Contract Clause "does not operate to obliterate the police power of the States . . . ," neither is that Clause "a dead letter." *Id.*, at 241. If the obligation imposed on appellant in this case had been imposed by the Alabama legislature in 1981, the substantiality of appellant's Contract Clause claim would rest squarely on the proposition that that legislative act could not, consistently with this Court's decision in *Spannaus* and its precusors in this Court, be applied retroactively on the contractual relationship between appellant and its insureds in Alabama.

That *Spannaus* would provide powerful support for appellant's challenge to such a hypothetical statute cannot be denied. Appellant's business of providing insurance coverage for medical expenses,

> "like other forms of insurance, depends[s] on the accumulation of large sums to cover contingencies. The amounts set aside are determined by a painstaking assessment of the insurer's likely liability. Risks that the insurer forsees will be included in the calculation of liability, and the rates or contributions charged will reflect that calculation. The occurrance of major unforseen contingencies, however, jeopardizes the insurer's solvency and, ultimately, the insureds' benefits. Drastic changes in the legal rules governing . . . insurance funds, like other unforeseen events, can have this effect."

438 U.S., at 246-47, *quoting Los Angeles Dept. of Water & Power* v. *Manhart*, 435 U.S. 702, 721 (1978).

That a legislative change in the legal rules governing appellant's contractual relationships with its insureds in Alabama such as that imposed by the court below would be "drastic" is adequately demonstrated by the $3,500,000 in punitive damages awarded in this case for failure to pay a $1,650.22 claim. In the business of insurance, claims over a long period of time involving vast numbers of claimants must be actuarially predicted in order to establish appropriate premiums and to set aside sufficient reserves to pay those claims. The contingency that such claims might then be multiplied by a factor of two thousand (or more) to add punitive damages cannot be calculated, computed or anticipated for the purpose of establishing premiums or reserves.

That Alabama would have no substantial countervailing state interest in imposing punitive damages, at least retroactively, under such a hypothetical statute, is an issue upon which three Justices of this Court have expressed strong views. *Smith* v. *Wade*, 461 U.S. 30, 57-65 (1983) (Rehnquist, J., joined by Burger, C.J., and Powell, J.). These views were not disputed by any other members of this Court in that case.

Appellant submits that the question whether Alabama can escape the full force of the Contract Clause as interpreted by this Court in *Spannaus* by the simple fortuitous circumstance that its judicial branch, rather than its legislative branch, legislated this drastic change in the legal rules governing appellant's contractual relationships with its insureds in Alabama is itself a substantial federal constitutional issue.

In 1924, this Court declared that the reinterpretation by a state court of a state statute was not an action, in and of itself, that would constitute a violation of the Contract Clause. *Tidal Oil Co.* v. *Flanagan*, 263 U.S. 444 (1924). Although the opinion in that case contains broad language suggesting that the word "law" as it appears in the Contract Clause could only mean "statute," *id.*, at 451, that dictum cannot be read as having settled this issue as presented in this case for at least four reasons.

First, where contracting parties enter agreements under which their respective obligations may be dependent on existing state statutory law, it is fair to say that they do so on full notice that an initial interpretation of that law by the state courts or a change in a previous interpretation of that existing state law may have the practical effect of altering their respective obligations. Such a situation is not comparable to one in which an obligation not existing at the time of entering a contract or performance under it may be imposed retroactively on one of the parties. The latter is what happened in this case by Alabama's creation in 1981 of a cause of action for bad faith failure to pay an insurance claim and its application in 1984 under previously unrecognized circumstances to performance under a contract in 1977 and 1978. Whether mere "clarification" of a common law obligation could, by itself, ever run afoul of the Contract Clause is a question which this Court will not have to decide in this appeal because of Alabama's establishment for the first time of a cause of action in 1981 and its radical expansion in 1984.

Second, this Court has long since put to rest the proposition that the word "law" as used in the First Amendment

might be read to encompass only statutes by imposing strict constitutional controls on the exercise by state courts of their power to formulate the rules for common law tort actions sounding in defamation. *See, e.g., New York Times Co.* v. *Sullivan*, 376 U.S. 254 (1964). As the Court stated in that case, the "test is not the form in which state power has been applied but, whatever the form, whether such power has in fact been exericsed." *Id.*, at 625. If the broad language of *Tidal Oil* were construed to preclude application of the Contract Clause to this case, then the continuing vitality of *Sullivan* and many subsequent and prior cases would itself present a substantial question.

Third, the elevation of form over substance with respect to what branch of state government created a particular legal rule governing private contractual obligations as suggested by the broad language of *Tidal Oil* could predictably nullify the result reached in cases such as *Spannaus* because the common law power of state courts to create new causes of action, particularly those sounding in tort, is extremely broad and largely unrestrained by the Constitution. For example, would this Court be prepared to hold that the creation today by the Supreme Court of Minnesota of a cause of action against Allied paralleling the statute struck down in *Spannaus* would not be susceptible to challenge under the Contract Clause? Appellant submits that such a result would be an absurdity.

Fourth, this Court's review of challenges to judicial action under the Contract Clause would present no unusual issues because a change in the substance of judicially created law would easily be evaluated under the same balancing approach followed in *Spannaus*.

This constitutional question is substantial because it cannot be regarded as having been settled in *Tidal Oil Co.* Indeed, a careful reading of *Tidal Oil Co.* and every prior case discussed therein discloses no suggestion that the *Tidal Oil* Court thought it was passing on the question presented by appellant here or that any of the cases discussed therein involved appellant's question.[12]

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[12] None of the many cases of this Court cited and discussed in *Tidal*

(footnote continued)

4. The Excessive Fine and Due Process Clause Question

The per curiam opinion below was straightforward in its statement of the purposes purportedly achieved by the imposition of $3,500,000 in punitive damages in this case for appellant's failure to pay a balance due of $1,650.22 on a total claim of $3,028.25: (1) "to punish the [appellant] for his oppressive, willful acts *and* (2) to warn or deter others in similar businesses from equally reprehensible conduct." App. A, *infra*, 34a. The opinion went on to demonstrate the inherent irrationality usually confined to juries as regards the calculation of punitive damages when, in denying appellant's argument to set aside the award as excessive, the opinion found appellant guilty of "fraud and conspiracy," even though fraud and conspiracy counts initially brought against appellant were withdrawn.

Were this a criminal prosecution, a $3,500,000 punitive award based, even in part, on an appellate court's finding of "fraud" and "conspiracy" would be set aside unless those specific charges had been submitted to a court or jury and decided against appellant. *Cole* v. *Arkansas*, 333 U.S. 196 (1948). The use of these findings against appellant by the court below, even if the award were viewed as civil, was, under *Saunders* v. *Shaw*, *supra*, probably a violation of appellant's federal due process rights. Indeed, if appellant's conduct were punishable under Alabama's criminal statutes related to business fraud and conspiracy, and if appellant had been convicted of business fraud and conspiracy under those statutes after enjoying the full protections of the Sixth and Fourteenth Amendments, the monetary penalty that appellant would have expected to have been assessed would be $3,000, §§ 13A-4-3, 13A-5-12, and 13A-9-41 *et seq.*, *Code of Alabama* (1975). Appellant comes to this Court having been severely punished by the

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(footnote continued from previous page)

Oil Co. v. *Flanagan*, 263 U.S. 444 (1924), involved an argument that the exercise by a state court of its common law power to impose new obligations on contracts through the recognition of a new cause of action would violate the Contract Clause. Thus, that decision cannot be read as dispositive of appellant's challenge to the retroactive imposition on its contract of the obligation created by Alabama in 1981 and reshaped in 1984.

courts of Alabama without having had the benefit of the protection of the Sixth Amendment or the Due Process Clause of the Fourteenth Amendment. Whether such unvarnished and excessive punishment in relation to the contract damages involved may be imposed under the Excessive Fine Clause of the Eighth Amendment or under the Due Process Clause *ex proprio vigore,* because of its arbitrariness and capriciousness, presents a substantial question that should be addressed by this Court in this case.

The proportional relationship between the $3,500,000 punitive damage award in this case and the contract damages involved or the potential criminal fine to which appellant might have been exposed is so staggering as to call on this Court, in the words of Justice Brandeis, "applying the Eighth Amendment, [to] make clear the 'difference between unrestrained power and that which is exercised under the spirit of constitutional limitations formed to establish justice.' " *Milwaukee Publishing Co.* v. *Burleson,* 255 U.S. 407, 435 (1921) (Brandeis, J., dissenting), *quoting Weems* v. *United States,* 217 U.S. 349, 381 (1910). *See also Solem* v. *Helm,* 463 U.S. 277, 103 S. Ct. 3001 (1983).

The question whether the Excessive Fine Clause is applicable to a punitive damages award which is grossly disproportional to the invasion of legal rights at issue is one of first impression in this Court but is no less substantial for that reason. Although this Court suggested in *Ex parte Watkins,* 32 U.S. (7 Pet.) 357, 361 (1833), that the Excessive Fine Clause serves to control only federal courts exercising criminal jurisdiction, that suggestion was dictum and, as observed by Justice Brandeis above, there would be no reason in principle not to apply that Clause to an excessive fine imposed for punitive purposes in a civil case if, as this Court has subsequently done. *See Furman* v. *Georgia,* 408 U.S. 238 (1972), the Eighth Amendment is to be applied at all to the States.

Whether addressed under the Excessive Fine Clause or directly under the Due Process Clause of the Fourteenth Amendment, the gross disproportionality of the fine in this

case, exacerbated by the operation of § 12-22-72, *Code of Alabama* (1975), which imposes a penalty on a penalty, presents a substantial federal question. There is no state interest in permitting this excessive fine to be awarded in this case, other than perhaps the State's interest in providing a "windfall," *Smith* v. *Wade*, 461 U.S., at 59 (Rehnquist, J., dissenting), to private citizens. There is no significant state interest in meting out punishment in a civil proceeding "based upon the caprice and prejudice of jurors." *Id.* And there is no deterrence here, assuming, *arguendo*, the imposition of excessive punitive damages ever has a significant deterrent effect, because the acts for which appellant is being punished occurred before the legal duty found to have been violated was even recognized in Alabama or its substantive content known to appellant or other insurers.

The decision below is not an aberration. On February 8, 1985 the Supreme Court of Alabama affirmed a directed verdict of $46,065 on a contract claim and $1,250,000 in punitive damages on a bad faith failure to pay an insurance claim in *Nationwide Mutual Insurance Co.* v. *Clay*, Nos. 82-537 & 82-917 (Ala. Feb. 8, 1985). App. I, *infra*, 285a. This Court has the power and responsibility to place constitutional restraints on such arbitrary awards before a proliferation of such verdicts ensues. The punitive damage award here is excessive both in kind because it serves no valid state purpose, and in degree because it is grossly disproportionate to the contract damages in this case.

CONCLUSION

Taken individually, appellant's federal constitutional claims are quite substantial. Appellant has been fined an amount vastly out of proportion to the damage which its conduct was found to have caused and it has been fined again in an amount hundreds of times greater than actual damages for the simple act of seeking recourse to the state's highest court. Its contractual obligations have been reformed retroactively far beyond any standard of foreseeability. Its case has been decided by a court which included a Justice with strong personal feelings regarding

appellant's business and a personal and fiduciary stake in the outcome of the legal issues under consideration.

Collectively these claims present a picture of a litigant deprived of many of the safeguards regarded as fundamental to the concept of due process. Probable jurisdiction should be noted.[13]

Respectfully submitted,

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[13] Because the court below denied appellant's Motion for Stay of Execution of Judgment, another ruling in this case apparently without precedent where a good and sufficient supersedeas bond has been posted, appellant sought an immediate stay of execution of the judgment from Justice Powell as Circuit Justice for the Eleventh Circuit. *Aetna Life Insurance Co.* v. *Lavoie*, No. A-728. On March 26, 1985, Justice Powell granted a temporary stay pending receipt by the Court of a response from appellees. Appellees filed a response on April 1, 1985, to which appellant responded on April 4, 1985. The March 26, 1985 order is reproduced in App. J, *infra*, 315a.